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Heike Proff and Harald V. Proff *

Effects of World Market Oriented Regional Integration on Developing Countries

The inward-oriented wave of regionalisation in the mid-sixties in the so-called developing countries was judged, twenty years later, to have been a failure almost everywhere. Since the beginning of the nineties a new trend towards regionalisation has been emerging, this time more strongly oriented towards world markets. Do the new regional integration agreements complement the economic and development policy effects aimed at by the structural adjustment programmes of the international financial institutions? What effects do they have on the economic development and the industrialisation of the countries involved?

Since the beginning of the nineties there has been an increased trend in the world economy towards regional trade agreements. Of particular importance for economic policy are, above all, MERCOSUR (Argentina, Brazil, Paraguay and Uruguay), AFTA (Thailand, Malaysia, Singapore, Indonesia, Brunei, the Philippines and Vietnam) and NAFTA (USA, Canada and Mexico). In addition to these there are a large number of other regional integration agreements in all parts of the globe in which less developed countries participate.¹

We can differentiate here between two general types of regional integration:²

☐ homogeneous regional integration: associations of countries at a similar level of development (examples are those among less developed countries in AFTA and MERCOSUR), and

☐ heterogeneous regional integration: associations of countries at differing levels of development (an example is the association of the industrial countries USA and Canada with the less developed Mexico in NAFTA).

Beyond this it is unnecessary to classify less developed countries according to their stage of development and to examine the corresponding country groups separately, for this could give rise to the

impression that newly industrialising countries (NICs) show considerably fewer development problems than the poorest country group of the least developed countries (LLDCs). If, however, the dualism of the economic structures in the NICs is taken into account, i.e. the considerable differences in income and development between the highly developed conurbations – which themselves show immense income disparities – and the extremely under-developed rural areas, the classification of developing countries proves to be highly problematical. If, furthermore, – as is the case in this article – economic development is understood to mean a structural change in the economy with a parallel increase in the participation of the population in the formal economic system, increasing industrialisation, urbanisation and a change in trade patterns and consumption habits,³ it is unnecessary to differentiate between less developed countries according to their stage of development when examining the effects of different types of world market oriented regional integration agreements.

¹ Cf. J. de la Torre, M. Kelly: *Regional Trade Arrangements*, Washington 1992, pp. 26 ff.

² Cf. H. V. Proff: *Freihandelszonen in Nordamerika – Ursachen und ökonomische Auswirkungen*, Wiesbaden 1994, p. 1.

³ Cf. F. L. Sell: *Ökonomik der Entwicklungsländer*, Frankfurt 1993, p. 2.

⁴ Cf. A. O. Krueger: *Perspectives on Development Economics and World Bank Research*, in: *Development Policy Review*, Vol. 4, 1986.

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In the eighties the economic and social problems in most of the developing and newly industrialising countries have become more acute, which is why this period is often described as a lost decade for development. None of the approaches of development economics was able to prevent the African and South American countries in particular from getting into grave development and debt crises. Essentially, four reasons are named for the difficulties of development theory in creating a basis for deriving concrete political strategies:

□ Compared to "pure" economic theory, development theory is highly normative. Because of the complex target function of development policy and in view of the multitudinous causes of underdevelopment, it has so far proved impossible to derive a self-contained theory of development. All the available approaches therefore deal only with partial aspects of underdevelopment and, in addition, often cannot easily be put to the practical test, so that they are inadequate to explain underdevelopment.⁴

□ The governments of the less developed countries, development cooperation organisations and both national and international financial institutions therefore follow ever-changing development policy strategies in rapid succession. Different and even contradictory concepts have at times been followed within one and the same donor organisation.

□ The dissolution of the centrally planned economies in Eastern Europe demonstrated the weaknesses of that economic system. A major alternative approach to a theory of economic development thus lost its credibility.

□ Attempts to find a "third path" to economic development between the centrally planned and the pure market-economy models were unable in most countries to fulfil the hopes placed in them.⁵

Following decolonisation in Africa and Asia and as a reaction to the industrialisation of South America in the mid-sixties, these countries increasingly began to develop their own concepts for the development of the economy. Since many of the less developed countries had established high external tariffs as part of an import substitution strategy, regional integration

agreements among these countries modelled on the EC seemed desirable: agreements on regional integration such as LAFTA in Latin America and ECOWAS in West Africa were made. Countries which had followed the development policy concept of import substitution as a preliminary stage to export orientation wanted to expand this strategy to the region. However, this meant that these efforts experienced a strong inward orientation,⁶ which made a later export orientation much more difficult. The inward-oriented viewpoint was strengthened in the negotiations themselves because at the centre of the agreements and contracts was, above all, the enforcement of national interests, e.g.⁷ on the issues of

□ the reduction of barriers to trade between the integrating countries,

□ the establishment of a common procedure with regard to foreign trade and payments policy,

□ the development of mechanisms to distribute the costs and benefits of integration among the individual countries, and

□ the reduction of barriers to factor trade.

In the seventies and eighties the translation into practice of the agreements negotiated was made even more difficult by external conditions (deterioration in the terms of trade, rise in the international interest rate level and impediments to access to international loans) and by domestic instability in the countries concerned. These problems finally caused the first, inward-oriented, wave of regionalisation among less developed countries to fail.

It has proved to be the case that the weaknesses of the development theory approaches and the problems connected with putting them into practice, e.g. within the framework of a regional integration agreement, have themselves increased, which in many countries has led to a development standstill. Combined with the increased difficulties in obtaining access to international loans, this explains the growing importance of the international financial institutions IMF (International Monetary Fund) and World Bank.

⁵ The situation in Mexico, which for a long time explicitly followed this "third path" to economic development, is a typical example; cf. G. M. Bueno, B. W. Poulson: Trade and Development Policy in Mexico in the context of North American Economic Relations, in: The North American Review of Economics and Finance, Vol. 1, 1990, pp. 187-203.

⁶ Cf. J. de Melo, A. Panagariya, D. Rodrik: The new regionalism: a country perspective, in: J. de Melo, A. Panagariya (eds.): New dimensions in regional integration, Cambridge 1993, p.159.

⁷ Cf. J. de la Torre, M. Kelly, op. cit., pp. 32-35.

SAPs and the Danger of Deindustrialisation

The crisis of development policy concepts is also to be seen in the increased borrowing from the international financial institutions IMF and World Bank. Particularly the loans from the "structural adjustment facilities" (SAF) and the "extended structural adjustment facilities" (ESAF) require coordinated action by the IMF and the World Bank and demand an extensive "policy framework paper" formulated jointly by the international financial institutions and the borrowing country, defining the conditions regarding structural adjustment.⁸ In this paper the financial institutions tie the granting of loans to extensive conditions with regard to the government policies of the borrowing countries. Between 1989 and 1994 the ESAF funds disbursed to borrowing countries rose from 264 million SDR to 2,831 million SDR. In the same period the number of countries taking out ESAF loans rose from 7 to 32.⁹

The international financial institutions IMF and World Bank attempt via the development of a concept for, and the funding of, the structural adjustment of the economy to re-establish the internal and external equilibrium of the economy which has been destroyed by the unsuccessful import substitution policy in many less developed countries, and to achieve self-sustaining growth in the long run. Whereas the IMF derives the conditions and fulfilment criteria attached to its loans from a financial programming model and does not follow any development policy concept beyond this, the World Bank complements its growth strategy based on neo-classical growth theory by a basic needs strategy with socio-political objectives: new jobs and the reduction of disparities in the distribution of income and wealth.¹⁰

General statements about the macroeconomic effects of the structural adjustment programmes (SAPs) can be derived only to a limited extent, since in spite of the uniform theoretical approach the concrete form varies greatly from country to country. For example, an extensive study comparing the development of the national economy in countries

with and without structural adjustment programmes in the eighties found hardly any significant improvements.¹¹ In contradiction to this is the concrete case of Ghana, where a structural adjustment programme following the complete collapse of the economy brought unmistakable improvements.¹²

Nor does the IMF follow any particular industrial policy concept in its programmes; their aim is simply in general to strengthen those, mostly export-oriented, enterprises which function efficiently. Unprofitable, often more strongly import-dependent firms are forced, in the face of harder competition and more expensive imports, either to undergo a radical streamlining and become profitable or to leave the market. The World Bank, which for a long time had primarily supported increased production capacities for both the domestic market and exports within the framework of project and sector related programmes, changed its emphasis in the mid-eighties in view of the increasing poverty of the population from large-scale industry to agriculture and small-scale industry.¹³ Furthermore, although the structural adjustment programmes attempt to support changes in the structure of the domestic economy in the direction of a stronger orientation towards foreign trade, and thus to create conditions which are favourable to private initiative, they do not, however, usually improve market access in other, particularly industrialised, countries. Together with the increasing competition from imports and the liberalisation of prices this leads to the risk of deindustrialisation.¹⁴

Industrial cores and a process of industrialisation emanating from them are, however, central elements of every development policy concept. There are five essential reasons for industrialisation in developing countries:¹⁵

- ☐ the close correlation between economic growth and industrialisation in the development process,
- ☐ the tendency of the terms of trade for agricultural products to fall,
- ☐ the greater development potential of industry compared to agriculture, since the income elasticity of

⁸ On this, cf. International Monetary Fund (ed.): *The International Monetary Fund*, IMF Survey, 1992.

⁹ Cf. International Monetary Fund: *Annual Report*, various years.

¹⁰ Cf. H. Proff: *Auswirkungen der Politik der internationalen Finanzinstitutionen (IWF und Weltbank) auf importintensive und exportorientierte Unternehmen in Ghana*, Saarbrücken 1994, chapter 2.2.

¹¹ Cf. J. Harrigan, P. Mosley: *Evaluating the impact of World Bank Structural Adjustment Lending*, in: M. H. Malik (ed.): *Contemporary issues in European Development Aid*, Aldershot 1991, pp. 83-119.

¹² Cf. H. Proff, *op. cit.*, pp. 270-273.

¹³ Cf. The World Bank (ed.): *Sub-Saharan Africa: From crises to sustainable growth. A long term perspective study*, Washington D.C. 1989, p.117.

¹⁴ Cf. H. Stein: *Deindustrialization, adjustment, the World Bank and the IMF in Africa*, in: *World Development*, Vol. 20, 1992, pp. 83-95.

¹⁵ Cf. H. Proff: *Strukturanpassungsprogramme und Industrialisierung in Schwarzafrika*, in: *Internationales Afrikaforum*, No. 1, 1995, p. 70.

domestic demand for manufactures is higher than that for basic foodstuffs,

- ☐ the positive employment effects of industrialisation, and
- ☐ the possibility of the substitution of imports.

Industrialisation as one component of development supports the transition from the subsistence and barter economy to the market economy, while at the same time rationalising all the processes of production. Despite the necessity of combating poverty in the short run, the medium and long-run industrialisation objectives must not be forgotten, for otherwise consumption will have to be financed for a lengthy period – with all the resulting consequences for the indebtedness of the developing countries – and development policy will degenerate to a “global social policy”.¹⁶ Of course it cannot be denied that social justice and the sustainability of economic development¹⁷ are important conditions for ensuring that the world economy will be capable of surviving in the long term. But for this reason to regard the industrialisation of the developing countries as being of less importance than socio-political objectives and to reject the further economic and social development of a large part of the world's population on the basis of sustainability theses, is unjustifiable, absurd and unrealistic. The supplying of scarce resources, also for future generations, should be our aim, not the continued exclusion from this supply of individual countries and continents.

In spite of the danger of deindustrialisation as a result of structural adjustment programmes there is so far no comprehensive and practical development policy alternative to them. The question therefore now poses itself, to what extent world market oriented regional integration agreements can promote economic development and, at the same time, industrial production and industrial exports, and thus complement the economic and development policy effects intended and achieved by the structural adjustment programmes.

Expansion of Industrial Production

Whereas earlier regional integration, which was inwardly oriented, was aimed above all at trade diversion (import substitution), the regionalisation trends since the beginning of the nineties in which less developed countries have participated (e.g. MERCOSUR, AFTA and NAFTA) concentrate on the creation of trade. The trade-creation effect is one of the non-monetary effects of regional integration¹⁸ and leads to increased trade between the participating countries due to the reduction in customs duties, which can result in the stimulation of the economies of these countries and the achievement of economic growth. This positive effect, which is based on the more efficient utilisation of the resources available in the participating countries, is in contrast to the trade diversion effect which arises because competitive products from third countries which are not party to the regional integration are replaced by less competitive products from the participating countries, which are cheaper because of the reduction in tariffs. Altogether, regional integration is expected to stimulate economic growth in the participating countries while having a priori undefined effects on third countries. In addition, it can be deduced that the welfare gains from regional integration are the higher, the greater the similarity of factor endowment in the participating countries and the greater the expansion of the market. These welfare gains result from increasing intraindustry trade, i.e. the parallel exporting and importing of similar goods within an economy, which in contrast to interindustry trade shows significant welfare gains for both factors of production according to the Stolper-Samuelson theorem.¹⁹

The regionalisation trends since the beginning of the nineties have thus been directed towards a greater participation in the world market, or have as their aim, by means of the creation of an attractive internal market, not to be cut off any further from events on the world market.²⁰ This demonstrates that

¹⁶ U. Menzel: Das Ende der dritten Welt und das Scheitern der großen Theorien, Frankfurt 1992, pp. 202 ff. Individual countries, mainly in Black Africa, already demonstrate this trend. Thus, for example, in Tanzania in 1994 a gross domestic product of US \$ 2.1 bn. confronted development aid transfers to the tune of US \$ 1.5 bn. (on this, cf. BfAI Länderreport – Tansania, Wirtschaftstrends zum Jahreswechsel 1994/95, 1995, p. 2).

¹⁷ Sustainability means the “search for a path of economic progress which does not impair welfare of future generations”. Cf. D. Pearce, E. Barbier, A. Markandya: Blueprint for a Green Economy, London 1990, p. 28; on the debate on sustainability cf. also H. Majer: Wirtschaftswachstum – Paradigmenwechsel vom quantitativen zum qualitativen Wachstum, Munich 1994.

¹⁸ Among the monetary effects the most interesting is the formation of larger currency areas via regionalisation. In Asia, for example, the importance of the yen is clearly increasing with the expansion of intraregional trade flows, and in North and South America regional integration limits the possibilities of individual national currency policies. North and South America are thus becoming a US dollar area, the intention of which is to achieve the stabilisation of the national currencies.

¹⁹ P. R. Krugman: Rethinking International Trade, Cambridge 1990, p. 50.

²⁰ Cf. L. Rubio: La globalización de la economía, in: S. Puche (ed.): Hacia un tratado de libre comercio en América del Norte, Mexico D. F. 1991, pp. 91-116.

the role attached to regionalisation in the development process takes place parallel to the changes in the economic and political environment.

The consequence of the emphasis on trade creation in the more recent regional integration agreements with their orientation towards the world market, for the less developed participating countries too, is – in addition to the pressure to adjust their domestic economic structures – that as a result of economic cooperation they have increased market access in, and increased opportunities for exports to, the other countries which are party to the agreement. If regionalisation is conducted with an orientation towards world markets in the form of an attempt to agree on trade-policy measures with both development policy and world-market oriented objectives simultaneously, then regional integration agreements can be expected to contribute towards an expansion of industrial production and industrial exports in the countries involved. These agreements would therefore have to be regarded as an important supplement to the structural adjustment programmes, in which on the one hand the necessary adjustments of distorted domestic economic structures are strengthened but on the other hand the weaknesses of the structural adjustment programmes, above all the lack of an opening up of export markets, would be overcome. The effects of world market oriented regional integration on economic development and finally on the industrial sector will therefore be more closely examined in the following.

Effects on Economic Development

Among the more recent world market oriented regional integration agreements in which less developed countries are participating, the NAFTA is the furthest developed, so that for Mexico the first economic policy effects can already be observed and there are a large number of both political and research studies forecasting the economic development of this country, which is the least developed of the parties to the agreement. Nevertheless, we shall also examine the possible, or already visible, effects of other regional integration agreements, above all the most important ones, AFTA and MERCOSUR, on the economies of the less developed countries involved.

The initial situation of Mexico before the beginning of the NAFTA negotiations was typical for a large

number of developing countries. Since 1982 the country had found itself in an economic policy dilemma between the requirements of stability on the one hand and a high rate of unemployment on the other. With the aid of the Phillips curve it can be shown that both stability and the reduction of unemployment cannot be achieved in the short term. On the one hand, a policy of price level stability leads necessarily to a decline in domestic demand, limiting domestic growth and thus the creation of additional jobs. On the other hand, a policy directed towards employment via an increase within a foreseeable space of time in the share of domestically financed investment in GDP,²¹ which aimed to guarantee the necessary jobs for the integration of those entering employment for the first time via high real economic growth, would endanger price level stability.

A possible way out of this dilemma is offered by long-term support for the export industries. The Mexican government hopes through NAFTA to be able to increase its exports via foreign investment and at the same time to create jobs without endangering the domestic price level.

Similar aims are being followed by the less developed countries in MERCOSUR and AFTA with the formation of these homogeneous world market oriented regional associations. In contrast to Africa and Latin America, the countries of Asia followed a strategy of export-oriented development very early on, which is now to be more strongly coordinated through AFTA.²²

The Mexican government's expectations with regard to the creation of a free trade zone with the USA and Canada are based on several economic model calculations. Common to them all is that they only deduce the medium and long-term effects of the agreements which arise additionally to the continuation of the status quo. They usually assume a period of ten years for the phase of restructuring in Mexico. All the studies forecast positive economic trends in Mexico. Expectations vary from an increase in national income of 1.5% to 8.1% as a result of the creation of NAFTA.²³

The forecast speed of integration under various trading agreements for the period 1997 – 2004, calculated as the difference between the average annual growth of trade and the average annual growth

²¹ Cf. M. A. Kiguel, N. Leviatan: When Do Heterodox Stabilization Programs Work?, in: The World Bank Research Observer, Vol. 7, 1992, pp. 35-57, here p. 43.

²² Cf. W. Lachmann: Entwicklungspolitik, Vol. 3: Außenwirtschaftliche Aspekte des Entwicklungsprozesses, Munich 1994, p. 206.

²³ Cf. H. V. Proff, op. cit., pp. 84-88.

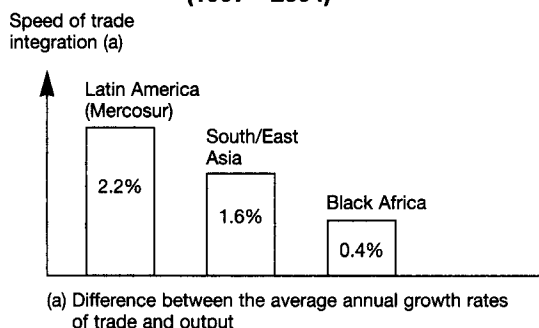
of output for the region concerned, underlines the external and export emphasis of the world market oriented regional integration agreements (cf. Figure 1). Despite large differences in the speed of integration of trade, over the forecast period there is a clear increase in the trade networking of the regions in international trade and therefore positive economic development can be expected in the long run.

The results of the model calculations and prognoses for all of the regions present a clear indication of positive macroeconomic effects for the less developed participating countries from world market oriented regional integration agreements. It is still unanswered, however, whether this is also a basis for sustainable industrial development, i.e. whether the industrial sector of the participating economies will also be able to take part in economic growth. The effects of economic integration on the industrial sector therefore require to be examined more closely. Only then can it also be judged to what extent the world market oriented regional integration agreements are able to support and realise the positive effects on the industrial sector which are intended by the structural adjustment programmes of the international financial institutions but which are often not realised by them.

Effects on the Industrial Sector

The processes of adjustment in the industrial sectors of less developed countries as a reaction to the formation of a world market oriented regional association vary depending on the stage of development of the countries involved and the nature of their trade flows. We have already differentiated

Figure 1
Expected Speed of Trade Integration
According to Regions
(1997 - 2004)



Source: World Bank: Global Economic Prospects and the Developing Countries, 1995, p.15.

above between participating countries at the same stage of development and at different stages of development (homogeneous and heterogeneous integration) and between interindustrial and intraindustrial trade flows. In interindustrial trade similar goods are either only exported from, or only imported to, any individual participating country to or from the others, whereas in intraindustrial trade similar goods are exported and imported at the same time. The nature of the trade flows supplements the index of "complementarity"²⁴ which is often applied in connection with regional integration. This index defines the degree of congruence of the baskets of imported and exported goods within a region and thus the interlinking of intra-regional trade. Without the differentiation between interindustrial and intraindustrial trade the effects on the industrial sector of the participating countries cannot meaningfully be deduced, however, so that in the following the nature of the trade flows will be examined directly and not the complementarity of baskets of traded goods. The possible effects on the industrial sector, as a function of the nature of the expected trade flows, can also be forecast for integration agreements among countries which previously hardly had any foreign trade at all due to trade barriers.

While in homogeneous integration agreements both purely interindustrial trade and a combination of interindustrial and intraindustrial trade (mixed trade) can be initiated and strengthened, the trade arising under heterogeneous integration agreements is ex definitione always mixed.²⁵ Thus, as a function of the congruence of the participating countries with regard to their stage of development and of the nature of their trade flows, three types of regional integration can be defined with significant differences in the adjustment processes in their industrial sectors:

- ☐ homogeneous integration with only interindustrial trade,
- ☐ homogeneous integration with both interindustrial and intraindustrial trade, and
- ☐ heterogeneous integration with both interindustrial and intraindustrial trade.

For the elucidation of these adjustment processes it is first of all necessary, however, to provide a brief description of the industrial sector in less developed

²⁴ Cf. World Bank: Global Economic Prospects and the Developing Countries, Washington 1995, p. 20 f.

²⁵ On this, cf. H. V. Proff, op. cit., pp. 95-112.

countries. Basically, industrial enterprises in these countries can be divided into three groups according to the nature of their production:

- ☐ the processing of raw materials and wage-intensive production,
- ☐ import substitution for the manufacture of capital-intensive products at a higher level of value added under the shelter of protectionism, and
- ☐ competitive and exportable production at a higher level of value added.

Firms belonging to the first group operate in the traditional industrial sector of less developed countries and produce interindustrially traded goods on the basis of comparative advantages, such as is explained by classical/neo-classical foreign trade theory. Firms from the second and third groups with production at a higher level of value added form these countries' modern industrial sector. Their production becomes internationally competitive and thus tradable by means, for example, of product differentiation. The "new foreign trade theory" explains intraindustrial trade flows with the existence of such firm-specific or competitive advantages.²⁶

Homogeneous Integration with Interindustrial Trade

If less developed countries form a world market oriented homogeneous regional association in which only interindustrial trade flows are initiated or strengthened, then there will be no enterprises there from the third group, which produce competitive and exportable products at a higher level of value added. The existing enterprises process raw materials or belong to the import substitution industry in the traditional industrial sector.

Integration affects above all the often government-owned import substitution industries, which manufacture inferior products with capital-intensive and usually inefficient methods under the shelter of protectionism, and which do not succeed in making the transformation to efficient, nationally and internationally competitive industries. Since the formation of a regional association means not only that they are faced with increasing competition as a result of the liberalisation of trade, but that the harmonisation of the economic policies of the

participating countries as a rule leads to the reduction of subsidies, many of these firms must leave the market. At the same time, however, even potentially successful import substitution projects are negatively affected. They would be able to achieve international competitiveness, but they fail without preliminary subsidisation and temporary protection in the early stages.

The resources which are set free by the closing down of these industries are diverted into the production and exporting of interindustrially tradable goods. For the industrial sector this means an increase in the processing of raw materials and wage-intensive production, since the basis for competitive and exportable manufacturing at a higher level of production has been removed. Thus, in a homogeneous regional association in which interindustrial trade flows are initiated or strengthened, welfare will increase in line with static, classical/neo-classical theory but industrial production will stagnate or even decline. There is a trend towards deindustrialisation, which could strengthen the unfavourable effects of the structural adjustment programmes on industry. The participating national economies are thus faced with a conflict of aims between the increasing of welfare and the increasing of industrial production.²⁷ The extremely controversial question must therefore be posed at this point as to the sustainability of the economic development initiated by homogeneous regional associations with only interindustrial trade among less developed countries in the light of the development aims for this type of integration.

The mechanisms inferred in this case correspond to the situation during the first wave of inwardly oriented regionalisation. A homogeneous association among developing countries, through which only interindustrial trade flows are initiated and strengthened, results in an unequal distribution of the costs and benefits of integration to the advantage of the country which is furthest developed, since this country can expand its preliminary advantage via regional integration. This national economy will accumulate industrial activities at the cost of the other countries participating in the association because of its slight development advantage, or even because of that of only a single conurbation, and the dualistic structure of the economy will be intensified.

²⁶ On this, cf. the theoretical deductions in, for example, H. Flam, E. Helpman: Vertical Product Differentiation and North-South Trade, in: *American Economic Review*, Vol. 77, 1987.

²⁷ Cf. C. A. Cooper, B. F. Massel: Towards a General Theory of Customs Union for Developing Countries, in: *Journal of Political Economy*, Vol. 73, 1965, pp. 464 f.

Homogeneous Integration with Mixed Trade

If less developed countries form a world market oriented homogeneous regional association which initiates and strengthens both interindustrial and intraindustrial trade, then in addition to the traditional industrial sector in the participating countries there will be a modern industrial sector with competitive and exportable production at a high level of value added. In the traditional industrial sector the same adjustment processes will take place as with the first type of integration with purely interindustrial trade. With the formation of a world market oriented regional association of this type, however, in addition the enterprises in the modern sector which have successfully completed the import substitution phase and are already diversifying their exports can

strengthen the production of intraindustrially traded goods because better sales opportunities for these products will arise on the markets of the participating countries. For this reason the possibility also arises for import-substituting firms which until now have not been exporting to avoid a main barrier to import-substitution industrialisation. Because of the low level of purchasing power in domestic markets and the protectionism of potential trading partners, many potentially successful enterprises which were founded within the framework of the import substitution strategy were unable to achieve sufficient economies of scale on the domestic market to be able to supply competitive goods of a higher value added to export markets, too.²⁸ In a homogeneous world market oriented regional association with mixed trade, enterprises can achieve higher economies of

Wilhelm Nordemann/Axel Nordemann/Jan Bernd Nordemann

Wettbewerbs- und Markenrecht

Competition and Trade Mark Law

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The law against unfair competition has two characteristic features: its topicality and its lack of transparency. The competition for markets and customers is a never-ending source for new ideas and methods. Because only very few case regulations exist, the bulk of the cases has to be decided under the general clauses of §§ 1 and 3 VWG. This leads to a wide variety of court decisions which in consequence blurs the distinction between the legal and the illegal. The book, therefore, offers an efficient orientation of competition and trade mark law. It also contains a number of helpful standard forms for the legal practice and a mock-examination for law-students.

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scale, so that even in less developed countries the production of industrial goods with a higher value added can be established. At the same time this lends support to technical progress and creates new jobs.

The relationship between modern and traditional industries depends on a large number of influencing factors, so that it is impossible a priori to estimate the total change in the industrial sector. Decisive influencing factors are the degree of competitiveness of the previously protected enterprises and the economic importance of the branches of industry which profit particularly from regional integration. In order to be able to infer further processes of adjustment in the industrial sector of less developed countries caused by the formation of a homogeneous association with mixed trade, the individual product markets of the relevant industries must be examined. The estimation of the sustainability of the potential industrial successes arising from world market oriented regional integration agreements will vary according to the structure and dynamism of these product markets.

Heterogeneous Integration with Mixed Trade

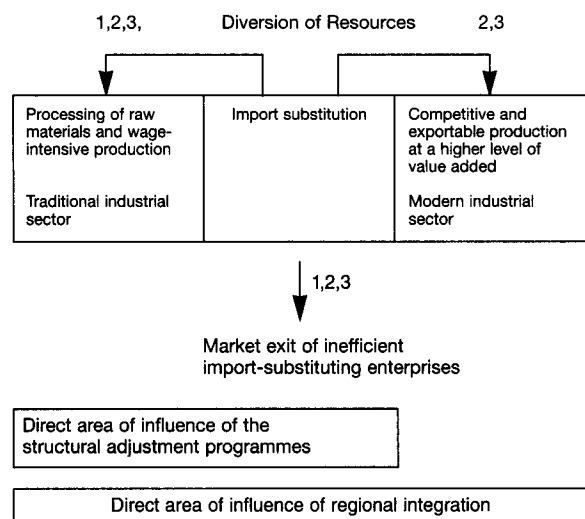
The adjustment processes inferred for the industrial sector of less developed countries from the formation of a homogeneous regional association with mixed trade also ensue for the industrial sector of the less developed participating countries in heterogeneous associations, since ex definitione mixed trade also takes place there and thus the modern industrial sector is supported, although with a greater degree of intensity. The potential sales in the internal market are much higher than in homogeneous regional associations due to the high level of purchasing power in the participating industrial countries. In view of the strong competition from enterprises from the participating industrial countries, the overall effects of heterogeneous integration on the industrial sector of the less developed countries is the more positive, the larger their modern sector is and the more enterprises of the third group are able to combine their country-specific and firm-specific advantages, or in other words their comparative and competitive advantages cleverly.

In Figure 2 the effects of the three types of regional integration on the industrial sector are summarised. The figure again shows clearly that both types of

world market oriented regional integration with mixed trade, both heterogeneous integration and homogeneous integration of type 2, offer support to enterprises in both the modern and the traditional industrial sector in less developed member countries. Only import-substitution industries which do not satisfy demand will be forced by this type of integration to leave the market. Other than in the case of structural adjustment programmes, the opening up of markets thus supports those areas of industry which produce intraindustrially tradable goods, so that manufacturing industry is also given a development perspective.

The formation of homogeneous associations with only interindustrial trade flows offers the industrial sector in less developed countries fewer chances of positive development, since at best a transition from import-substitution industries into the traditional sector is to be expected there. For enterprises in the modern sector neither the potential exists nor will it be created by this type of integration. Most of the import-substitution industries will be forced out of the market, which is certainly necessary in the case of unprofitable firms but can overall result in a trend towards deindustrialisation. If only interindustrial trade flows exist or are to be expected, a strengthening of export activities directed towards third countries and mechanisms which distribute the costs and benefits

Figure 2
Adjustment Processes in the Industrial Sector of LDCs in Different Types of Regional Integration



²⁸ Cf. M. Ehrke: Internationale Produktion in Mexiko, in: Vierteljahresberichte, No. 87, 1982, p. 54.

of integration between the participating countries are necessary if regional integration is not to fail for the same reasons as did the first wave of regionalisation among developing countries.²⁹ Nevertheless, even with this first type of integration a too pessimistic estimation based on static considerations does not seem justified and it is not to be recommended to give priority to the unilateral dismantling of barriers to trade over regional integration.³⁰ This would only further strengthen the trend towards deindustrialisation caused by structural adjustment programmes. Moreover, the enlargement of the internal market could both fulfil a necessary condition for the establishment of intraindustrial trade relationships and offer an opportunity for doing so. In order for this opportunity to be used, however, development policy specifications are required for the private initiatives which intensively promote intraindustrial trade.

Altogether, therefore, world market oriented regional integration agreements not only have a positive effect on the development of the economy as a whole but they also have a largely positive economic effect on the industrial sector, in that industrial cores are strengthened and supported. Regional integration can thus counteract the danger of deindustrialisation emanating from structural adjustment programmes. The question remains unanswered, however, as to the long-term development policy sustainability of these efforts in view of the possible reactions by third parties in the international economy.

Development Policy Sustainability

At first glance world market oriented regional integration agreements appear to support economic development in the less developed participating countries. This is sufficient for their effects to be much more positive than those of the first wave of regional integration, which was inwardly oriented, in the mid-sixties. World market oriented regional associations create, in addition, the general conditions for an increase in industrial production and industrial exports. They are therefore a meaningful and necessary supplement to the structural adjustment programmes of the international financial institutions in less developed countries, the intention of which is a process of transformation in the industrial sector toward internationally competitive enterprises which utilise domestic resources, but which do not

adequately support this process and thus contain the danger of deindustrialisation.

This positive estimation of the effects of world market oriented regional integration agreements for the less developed participating countries does, however, in view of the limited growth of world markets and the rapidly increasing number of regional associations among developing countries, pose the question as to their long-term sustainability as a development policy alternative. While the long-term economic sustainability of the regional associations oriented towards the domestic market was dependent on the success of the import substitution strategy, the judgement of the sustainability of the world market oriented regional associations must take the reactions of other actors on world markets into account. Two points appear particularly important here:

- ☐ the influence of multinational enterprises in these countries, and
- ☐ the world-wide (export) competition among less developed member countries of different world market oriented regional associations.

Influence of Multinational Enterprises

As to the first of these, it could be shown that regional integration leads to a positive development of the economy as a whole in the less developed participating countries and thus to growing domestic markets. Primarily in Asia, but also in Latin America, growth rates are being achieved and forecast which to an increasing extent are arousing the interest of multinational enterprises. Although there are often long transitional periods before the removal of customs duties will be completed (in NAFTA, e.g., not until 2009), the formation of a regional association already means the establishment of more stable economic and political conditions, which are an essential prerequisite for strategical reactions by enterprises. This is particularly important for the involvement of multinational enterprises in less developed countries, since unstable economic and political conditions as a rule increase the risk premiums, making many investments unprofitable. This is the reason why, in particular, regional associations in which countries participate which have until then been less developed are regarded as the long-term relevant fields of activity for international management.

²⁹ One possible solution for this is, for example, the customs drawback approach; on this cf. P. G. Elkan: How to beat backwash – the case for Customs-Drawback Unions, in: *Economic Journal*, Vol. 75, 1965, pp. 44-62.

³⁰ On this cf. P. Collier, J. W. Gunning: Trade Policy and Regional Integration: Implications for the Relations between Europe and Africa, in: *The World Economy*, Vol. 18, 1995, pp. 391 ff.

The most important change brought about by regional integration from the point of view of the multinational enterprises is the improvement in sales conditions.³¹ The previously tight domestic markets in the individual countries participating in a regional integration agreement have often prevented a greater involvement by foreign firms because exports were often hindered by import restrictions and the necessary investments would not have been worthwhile. Regional integration improves the procurement conditions for firms engaged in the area, since the supply of raw materials and semi-finished products in the region is extended and foreign enterprises in particular can at the same time increase their pressure on domestic suppliers.

The investment conditions improve via regional integration at first only for enterprises from the participating countries since their governments primarily wish advantages to accrue to their home firms; enterprises from third countries are to be excluded.

This is evident above all in requirements placed on enterprises from third countries concerning the regional value added ("local content") as a condition for duty-free sales in the member countries and in regulations governing foreign exchange compensation. In the NAFTA negotiations a 50% "regional content" was agreed. Final assembly plants with a very low depth of value added are not supported by regional integration. On the other hand, however, less developed countries in particular are very interested in foreign direct investment as a motor for more rapid economic development. But also simply in view of the improved sales and procurement conditions and, for example, the possibility of realising economies of scale it would probably be worthwhile for subsidiaries of third country enterprises to produce a large part of their value added in the region in order in this way to fulfil the "regional content" requirements.

Since the interests of multinational enterprises and those of governments are quite different, conflicts in the development process can arise here, above all since multinational enterprises attempt to internalise the effects of the positive development of the economy. If development policy is badly managed

this can lead to substitution effects between domestic and multinational enterprises. From the point of view of industrial and development policy this leads to the danger that the positive developments inferred in the industrial sector of less developed countries can be weakened by competition from third countries. Regarded from a macroeconomic point of view this is not directly negative due to the positive effects of foreign direct investment (inflow of capital, job creation or technologies) but it cannot be ignored that the use of in-company transfer prices for the allocation of profits in the multinational enterprises causes the revenue for the developing country to fall, a loss which is not taken into account in purely macroeconomic models.

Worldwide Competition

With regard to the second of the two points mentioned above, in view of the growing competition on world export markets between the individual regions, whose baskets of export goods are becoming increasingly similar, future competition between the individual regions can be expected to become much harder. Similar to the situation regarding agricultural exports of cash crops, which were cultivated and exported by an increasing number of developing countries, leading to the collapse of prices on world markets, an over-supply of substitutable, manufactured export goods can have a negative influence on prices. In individual cases the competition among developing countries might even be greater than the competition between developing and industrial countries.³² In that case the expected positive economic forecasts, which until now have hardly paid any attention to competition among the individual regions, would have to be corrected downwards. A possible solution is offered by the search for niches for manufactured products on world export markets.

Despite these limitations, world market oriented regional integration agreements among less developed countries appear to promise success. In order to guarantee their development policy sustainability efforts will have to be made not only to produce and export intraindustrially traded products in addition to interindustrially traded ones, but also to follow a differentiated policy towards multinational enterprises and to look for niches on world markets. If they take these ideas into consideration, world market oriented regional integration agreements offer a chance of sustainable economic and industrial development.

³¹ Cf. H. Proff, H. V. Proff: Bedeutung der zunehmenden Regionalisierung der Weltwirtschaft für die Wettbewerbsstrategien internationaler Unternehmen, to be published in: Zeitschrift für Betriebswirtschaft, Vol. 66, 1996, No. 4.

³² Cf. V. A. Muscatelli, A. A. Stevenson, C. Montagna: Intra-NIE competition in export of manufactures, in: Journal of International Economics, Vol. 27, 1994, p. 44.